Group Economics

Ulster Bank

The next financial crisis Made in China?

Contact: Richard Ramsey
Chief Economist, Northern Ireland
02890 276354 or 07881 930955

Richard.ramsey@ulsterbankcm.com
www.ulstereconomix.com
Twitter @UB_Economics

Article appeared in Irish News Business Insight 10th November 2015

Over eight years has passed since the start of the global financial crisis. This began with the so called 'credit crunch' in August 2007. More recently, those well-worn terms 'credit crunch' and 'financial crisis' have returned to the headlines of the financial media. While the last crisis was born in the USA, the land of the sub-prime mortgage, the next one could well be made in China.

Financial crises are not that rare. Since the 1970s, there have been 217 currency crises, 147 banking crises, and 67 debt crises. These have included crises in the Far East, in Europe, in the US, South America and elsewhere. One country that has never experienced a financial crisis though is China.

But could that be about to change?

According to China expert Linda Yeuh, who was speaking at last weekend's Kilkenomics festival at Kilkenny, the question isn't 'if' China will have a financial crisis but rather 'how big' will it be?

So, should we in the Western world worry? After all, Asian financial crises are not new and the last one in 1997/98 didn't have a major impact on us (although it did wreak havoc in Asia).

It is worth pointing out that back then the so called Emerging Economies *(in Asia, South America & Africa)* accounted for 42 percent of world GDP with the Developed Economies *(e.g Western Europe & North America)* making up 58 percent.

Fast forward to 2015 and those ratios have been reversed. Incidentally at the time of the global financial crisis, the developed economies and emerging economies' share of world GDP was broadly the same. That means that the developed world is now much more exposed to economic and financial developments in emerging economies such as China than ever before. Therefore an emerging markets economic slowdown or financial crisis has the potential to do a lot of economic damage to global growth.

China was instrumental in getting the global economy out of recession in 2009. China and the emerging economies in Asian and South America engaged in the heavy lifting required for the global economic recovery. Unlike the developed world, China had very low levels of public sector debt and it was well placed to embark upon a massive fiscal stimulus and an investment boom of Klondike proportions.

China's influence on the world economy has changed markedly over the last 10-15 years and since the last global financial crisis. A decade ago China and the US both contributed equivalent shares of global GDP (16% each). Now China (29%) makes almost double the contribution to global growth that the US makes (15%). Over the five-year period from 2007-2012, China accounted for half of all global economic growth. Meanwhile emerging economies have accounted for 70 percent of global economic growth each year since the crisis.

China is the biggest manufacturer and exporter on earth and the primary source of demand for raw materials. For example, China accounts for half of global metal consumption. The latter has seen Chinese trade with Africa increase tenfold since 2000. There are more iPhones sold in China than the US, and China accounts for 30 percent of the global car sales market (Europe 25%, US 12%). It is noted that 3½ times as many countries now have China as their top export partner as was the case when Lehman Brothers collapsed (Sept-2008). China is also a key source of FDI with Chinese companies acquiring a number of household names such as Weetabix and Volvo in recent years.

In recent months, however, there has been increasing concern about an emerging markets economic slowdown (China in particular) and how this will impact on economies elsewhere. China's economic slowdown has been transmitting across other emerging markets with the current rates of decline in world trade normally associated with a global recession.

The slowing Chinese economy is therefore pulling other economies down with it as its previously-voracious appetite for commodities wanes. This has been evident recently with China dumping its oversupply of steel on world markets at cheap prices.

Economies exposed to commodities and Chinese trade are particularly vulnerable. This includes Northern Ireland which manufactures equipment for the quarrying and mining industries. Remember a frequent boast within Northern Ireland is that 40 percent of the world's mobile crushing and screening equipment (mining & quarrying industries) is made here. Therefore, while China accounts for only 1.5 percent (£94m) of Northern Ireland's manufacturing exports, the indirect exposure to a Chinese economic slowdown is much greater.

An economic slowdown has been on the cards for quite some time, as China's economic growth has been unprecedented in both scale and duration. However, this well-trodden path of investment-based growth has been seen before (e.g. in Japan & South Korea). China's issue is that it looks to have gone too far and it started to rebalance to household consumption too late.

Financial crises are normally preceded by a period of private sector credit expansion. China fits this pattern. No country that has witnessed the expansion in credit that China has already seen has avoided a financial crisis. China's credit boom also occurred within China's unique political environment. Corruption is rife and lending followed political criteria not economic or financial. Therefore China's banking sector is likely to be sitting on non-performing loans well in excess of official estimates.

China has plenty of firepower to deal with a crisis but the policy response will be critical.

Richard Ramsey
9th November 2015

This document is issued for information purposes only for clients of Ulster Bank Group who are eligible counterparties or professional customers, and does not constitute an offer or invitation to purchase or sell any instrument or to provide any service in any jurisdiction where the required authorisation is not held. Ulster Bank and/or its associates and/or its employees may have a position or engage in transactions in any of the instruments mentioned.
The information including any opinions expressed and the pricing given, is indicative, and constitute our judgement at time of publication and are subject to change without notice. The information contained herein should not be construed as advice, and is not intended to be construed as such. This publication provides only a brief review of the complex issues discussed and readers should not rely on information contained here without seeking specific advice on matters that concern them. Ulster Bank make no representations or warranties with respect to the information and disclaim all liability for use the recipient or their advisors make of the information. Over-the-counter (OTC) derivatives can involve a number of significant and complex risks which are dependent on the terms of the particular transaction and your circumstances. In the event the market has moved against the transaction you have undertaken, you may incur substantial costs if you wish to close out your position.

Ulster Bank Limited Registered Number: R733 Northern Ireland. Registered Office: 11-16 Donegall Square East, Belfast BT1 5UB.
Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Member of The Royal Bank of Scotland Group.

Ulster Bank Ireland Limited . A private company limited by shares , trading as Ulster Bank , Ulster Bank Group and Bank Uladh. Registered in Republic of Ireland. Registered No. 25766. Registered Office: Ulster Bank Group Centre, George's Quay, Dublin 2. Member of the Royal Bank of Scotland Group. Ulster Bank Ireland Limited is regulated by the Central Bank of Ireland.

Calls may be recorded.

RBS **Ulster Bank Limited accepts no liability for the outcome of any actions taken arising from the use of this article**